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Supreme Court of the United States,

OCTOBER TERM, 1929.

No. 344.

CHARLES A. CORLISS,
Plaintiff-Appellant,

against

FRANK K. BOWERS, AS COLLECTOR OF INTERNAL REVENUE FOR THE SECOND DISTRICT OF NEW YORK,
Defendant-Respondent.

BRIEF OF PLAINTIFF-APPELLANT.

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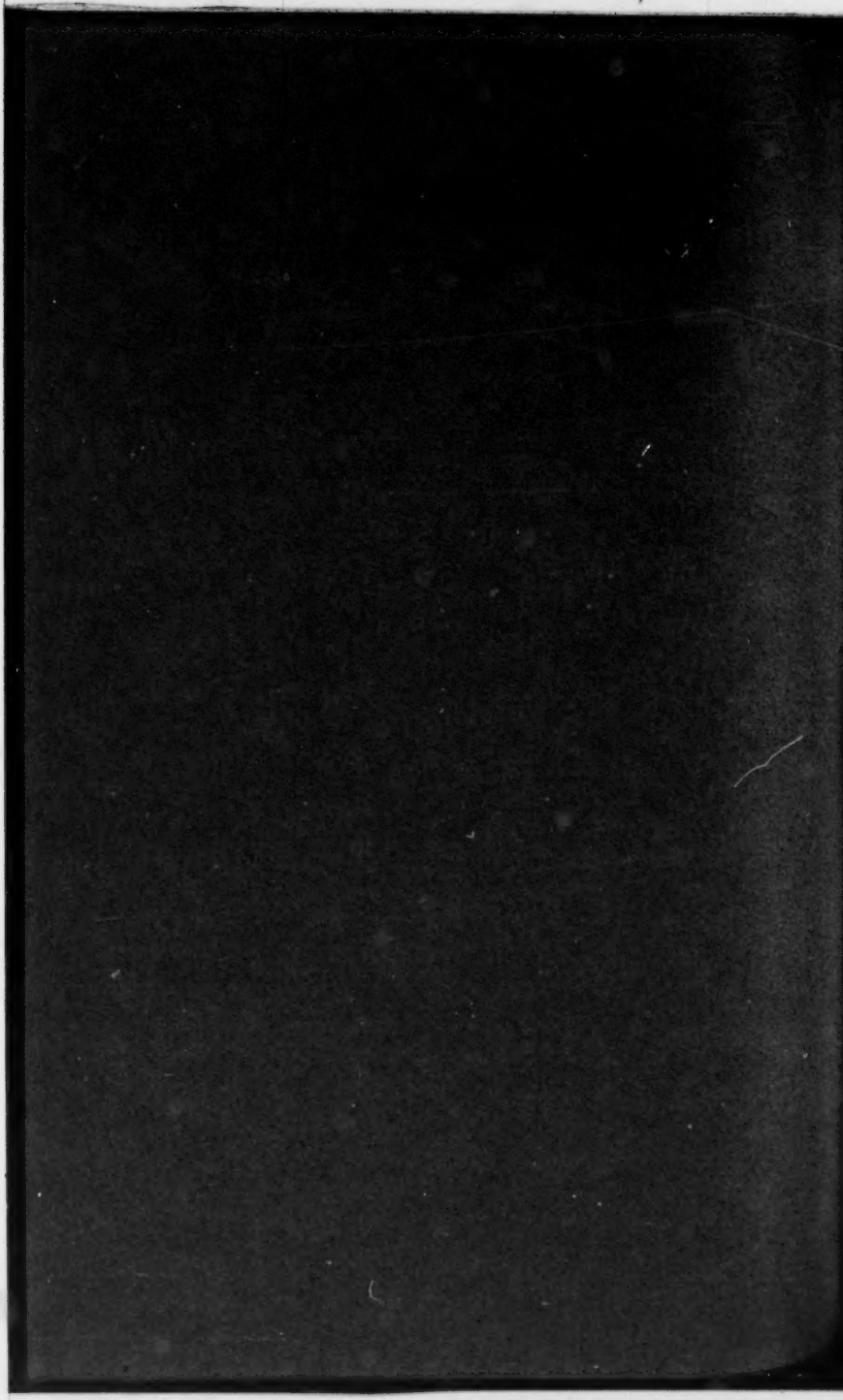

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No. 344

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against

FRANK K. BOWERS, as Collector of Internal Revenue for the Second District of New York,
Defendant-Respondent.

BRIEF OF PLAINTIFF-APPELLANT.

Statement.

This action was commenced in the District Court of the United States for the Southern District of New York on April 4, 1927 to recover federal income taxes amounting to $48,338.32 paid by appellant to respondent for the calendar year 1924, on the ground that the provisions of the Revenue Act of 1924 which taxed to the donor the income of a revocable trust, were unconstitutional and void. To the complaint of the appellant the respondent filed a motion to dismiss on the ground that the complaint fails to state a cause of action. (R., fol. 4) The District Court rendered a judgment dismissing the complaint on July 21, 1929. (R., fol. 3) The opinion of the District Court (R., pp. 22-27) is reported in 30 Fed. (2d) 135. An appeal was taken from this judgment to the Circuit Court of Appeals for the Second

Circuit. The Circuit Court unanimously affirmed the judgment of the District Court by decree dated July 1, 1929. (R., fol. 62) The opinion of the Circuit Court (R., pp. 29-33) is reported in 34 Fed. (2d) 656.

The appellant thereupon petitioned to this Court for a writ of certiorari to the said Circuit Court. The order allowing certiorari was filed October 21, 1929. (R., fol. 64)

The appellant relies upon the Judicial Code, Sec. 240, as amended by Act of February 13, 1925 (43 Stat. 938), as authority for the jurisdiction of this Court.*

The Complaint.

The material allegations of the complaint (R., pp. 3-21) which has been dismissed as failing to state a cause of action may be summarized as follows:

On December 29, 1922, the appellant, in New York City, delivered to Bankers Trust Company, a New York corporation, a trust indenture, a copy of which is annexed to the complaint (R., fols. 15-23) and at the same time delivered to the trustee corporate stocks and bonds listed in the schedule annexed to the indenture. (R., fol. 24) Under the terms of the trust indenture the securities listed in the schedule annexed thereto were assigned to the trustee, which was required to collect the income therefrom and to pay the same to Anne Parrish Corliss, the appellant's wife, for the term of her life. The indenture directs that upon the death of the life beneficiary the principal of the trust shall be paid in equal shares to the children of the appellant then living and the issue of any deceased children, and, in default thereof,

* The United States District Court for the Western District of Pennsylvania in the case of *Clapp* v. *Heiner,* 34 F. (2d) 506, has rendered a decision in a similar case which follows the decision of District Judge Mack in the instant case.

o such persons as Anne Parrish Corliss shall in her will esignate and appoint.

The complaint expressly alleges that the trust so created constituted a bona fide, valid trust under the laws of the tate of New York". (R., fols. 6-7)

In the trust indenture the appellant reserved the right to modify or alter in any manner, or revoke in whole or in art" the indenture and the trusts and estates created hereby. (R., fol. 20) The appellant at no time exercised ny of such powers and in the year 1924 the trustee paid ver to Anne Parrish Corliss, the beneficiary, the entire net ncome of the trust for that year, amounting to $124,325.97. R., fol. 7) None of the income of the trust was paid or redited to the appellant or received by him in 1924, or in ny other year. (R., fol. 8) Appellant reported no part of he income of the trust as taxable to him for the year 1924, ut attached to his income tax return a rider disclosing the mount of the trust income and claiming exemption from tax hereon. (R., fols. 8-9) An additional tax of $44,687.43 ith interest of $4,115.83 was thereafter assessed against the ppellant, such assessment resulting solely from the inclusion n the appellant's net income for 1924 of the net income of he trust (R., fol. 10), all of which had been paid to the eneficiary under the terms of the trust indenture. Appel- nt paid the additional tax and interest so assessed (R., fol. 0) and his claim for the refund thereof was rejected by the ommissioner of Internal Revenue. (R., fol. 11)

The Issues.

The sole issues involved are whether subdivisions (g) and h) of Section 219 of the Revenue Act of 1924 are constitu- ional and, if so, whether they are constitutional as applied o trusts created prior to the enactment of the 1924 Revenue ct.

The Statute and Its Historical Background.

The pertinent subdivisions of Section 219 of the Revenue Act of 1924 read as follows:

> "(g) Where the grantor of a trust has, at any time during the taxable year, either alone or in conjunction with any person not a beneficiary of the trust, the power to revest in himself title to any part of the corpus of the trust, then the income of such part of the trust for such taxable year shall be included in computing the net income of the grantor.
>
> "(h) Where any part of the income of a trust may, in the discretion of the grantor of the trust, either alone or in conjunction with any person not a beneficiary of the trust, be distributed to the grantor or be held or accumulated for future distribution to him, or where any part of the income of a trust is or may be applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in paragraph (10) of subdivision (a) of section 214), such part of the income of the trust shall be included in computing the net income of the grantor."

Prior to the Revenue Act of 1924, none of the federal income tax laws contained any special provision pertaining to revocable trusts. Under the express terms of such laws the recipients of trust income were taxable thereon. The Treasury Department, however, took the position as early as 1916, that the income of revocable trusts was taxable to the grantor of the trust even though paid to a beneficiary other than himself. This position being clearly unsound under the Revenue Acts of 1916, 1918 and 1921, the pertinent regulations of the Treasury Department were generally disregarded by grantors of such trusts, who were sustained in their position by the Solicitor of Internal Revenue when the question was presented for legal review in 1922.

In that year, Mr. Carl A. Mapes, the then Solicitor of Internal Revenue, rendered an exhaustive opinion (L. O.

1102, Cumulative Bulletin I-2, page 50), in which he held that income received by beneficiaries other than the grantor of the revocable trust under consideration did not constitute income of the grantor and was not taxable to him as such. As a result of this opinion, the Treasury Department thereafter published a ruling (I. T. 1589, II-1 C. B. 51) which provided that L. O. 1102 was applicable to all income tax laws, and concluded:

> "The nature of the return required and the liability for the payment of tax in the case of a revocable trust are determined in the same manner as in the case of trusts which are not revocable."

This ruling remained effective for all years prior to the year 1924, with the result that beneficiaries of revocable trusts have paid taxes for such years upon trust income received by them.

In proposing the inclusion of subdivisions (g) and (h) of Section 219 in the Revenue Act of 1924, the Report of the Finance Committee of the Senate (Vol. I, Senate Reports, Sixty-Eighth Congress, First Session, at p. 25) states:

> "Sec. 219: This section has been rewritten in order to secure clarity and to prevent the evasion of taxes by means of estates and trusts.
>
> * * * * * *
>
> "The creation of a revocable trust constitutes nothing but an assignment of the right to receive future income. Since such an assignment does not operate to increase (*sic*) the taxable income of the assignor, the creation of a revocable trust should not so operate, but the income of such trust should be included in the income of a grantor. The bill so provides."

From the context, it is apparent that the Committee intended to use the word "decrease" instead of "increase" where the latter appears in the above quotation.

As a result of this change in the Revenue Act of 1924, the income of revocable trusts, which had for years been taxed to the beneficiaries, was made taxable for the year

1924 and subsequent years to the grantor. Congress thus assumed authority to tax income of a revocable trust to either one of two persons, the grantor or the beneficiary. With due appreciation of the importance of the income tax and the value of its contribution to national revenue, it is submitted that its importance does not transcend in importance the observance of long settled principles of trust law and well defined constitutional limitations.

POINT I.

The trust indenture of December 29, 1922, vested the legal title to the corpus of the trust in the trustee and the equitable title in the beneficiary, and the income from the corpus was the income of the beneficiary.

Under the trust deed of December 29, 1922, the trustee became vested with legal ownership of the trust principal and the beneficiary became vested with the equitable ownership thereof. Until the exercise of the power of revocation reserved by the grantor, the transfer, so far as material here, was as complete and effective when made as though the trust had been irrevocable.

This has been clearly recognized by this Court. In *Jones v. Clifton*, 101 U. S. 225, it was said (p. 229):

> "The powers of revocation and appointment to other uses reserved to the husband in the deeds in question do not impair their validity or their efficiency in transferring the estate to the wife to be held by her until such revocation or appointment be made."

In that case the conveyance was directly to the wife of the settlor, who reserved the power of revocation. After the settlor had become insolvent, his assignee in bankruptcy sought to set aside the deed or to exercise the power of

revocation reserved therein. In denying the assignee the rights asserted this Court said (p. 230):

> "The title to the land and policies passed by the deeds; a power only was reserved. That power is not an interest in the property which can be transferred to another, or sold on execution, or devised by will. The grantor could, indeed, exercise the power either by deed or will, but he could not vest the power in any other person to be thus executed. Nor is the power a chose in action. It did not, therefore, in our judgment, constitute assets of the bankrupt which passed to his assignee."

Both the Federal Circuit Court for the Second Circuit and the Court of Appeals of the State of New York have recognized that, until revoked, a revocable trust, under New York law, creates an estate as valid and effective as if the trust had been irrevocable. In the recent case of *The Farmers' Loan & Trust Company* v. *Bowers*, 29 Fed. (2d) 14 (C. C. A., 2d Circ.), Circuit Judge Manton said (p. 17):

> "A power to revoke is not a property right nor an interest in property. *Jones* v. *Clifton*, 101 U. S. 225; *Hill* v. *Nichols*, 18 Fed. (2d) 139; *Reinecke* v. *Northern Trust Co.*, 24 Fed. (2d) 91; *In re Dolan's Estate*, 279 Pa. 582; *Stone* v. *Hackett*, 12 Gray (Mass.) 227. The power of revocation is perfectly consistent with the creation of a valid trust. Title passes to the donee and remains vested for the purpose of the trust even though there be a right to revoke it. The power to revoke is not evidence of an intent to postpone the legal enjoyment, existence or effect of that which may perhaps thereafter be brought to an end for the reason that the enjoyment and possession actually passes to the beneficiaries. Until the right to revoke is exercised an estate exists by virtue of the transfer. *People* v. *Northern Trust Co.*, 289 Ill., 475; *In re Dolan's Estate, supra.* Such a power is not transferrable or descendible nor may it be alienated or passed by a will. It is personal to the holder. *Lewellyn* v. *Frick*, 268 U. S. 238; *Jones* v. *Clifton, supra; Reinecke* v. *Northern Trust Co., supra.*

When in May, 1916, the settlor made his indenture, he transferred his title and also all possession and enjoyment. His reserved powers were not conditions of the vesting of the estate, but merely conditional limitations. Such has been the rule under the transfer tax in New York State referring to a transfer intending to take effect in possession and enjoyment at or after death. *Matter of Miller,* 236 N. Y. 290; *Matter of Carnegie,* 203 App. Div. 91, affd. 236 N. Y. 517."

In the leading New York case of *Van Cott* v. *Prentice,* 104 N. Y. 45, 52, 55, Judge Finch said:

"Neither the power of revocation nor the provisions determining the trust in the event of a legal interference, or the death of the trustee in the life of the settlor, are in the least inconsistent with the trust as completely and perfectly constituted. They both assume its separate and effective existence and provide merely for its termination upon the happening of specified contingent events. * * * We discover nothing in the provisions of the deed, properly construed, inconsistent with a completely constituted trust, wholly voluntary and benevolent, and subject to revocation by the settlor at any moment; a kind of trust of which the books furnish many instances, and which, indeed, are sometimes subject to doubt and suspicion if the power of revocation is absent."*

Both Judge Mack of the District Court for the Southern District of New York and Judge Manton of the Circuit Court

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* In addition to the cases above referred to and the citations included in the quotations, to the same effect see:

Von Hesse v. *MacKaye,* 136 N. Y. 114, 32 N. E. 615;
Schreyer v. *Schreyer,* 101 App. Div. 456 (affd., 182 N. Y. 555);
Nichols v. *Emery,* 109 Cal. 323, 41 Pac. 1089;
Hellman v. *McWilliams,* 70 Cal. 449, 11 Pac. 659;
Dickerson's Appeal, 115 Pa. 198, 8 Atl. 64;
Stone v. *Hackett,* (Mass.) 12 Gray 227.

of Appeals for the Second Circuit have recognized this contention in their opinions. Judge Mack said (R., fol. 43):

> "The creation of a revocable trust vests in the beneficiary a present estate in all respects valid until the power of revocation is exercised. *Jones* v. *Clifton*, 101 U. S. 225; *Van Cott* v. *Prentice*, 104 N. Y. 45."

Judge Manton makes a like observation at Record, fol. 57.

The cases of *Reinecke* v. *Northern Trust Company*, 278 U. S. 339, and *Chase National Bank* v. *United States*, 278 U. S. 327, are not in conflict with this position. The most that those cases can be said to hold is that where the grantor of a trust or the insured under a life insurance policy reserves the right to revoke the trust or change the beneficiary of the insurance policy, the termination of that power at death causes a shifting of "economic benefits" which is the legitimate subject of the *excise tax* imposed by the federal estate tax law. Indeed, in the *Chase Bank* case it is stated (p. 338):

> "Termination of the power of control at the time of death inures to the benefit of him *who owns the property* subject to the power." (Italics supplied.)

On the argument of this case in the Courts below counsel for the Government placed considerable reliance upon Section 145 of Chap. 50 of the Consolidated Laws of New York (Real Property Law)* in support of the proposition that the grantor of a revocable trust is both technically and in substance the owner of the trust principal during the time the trust remains in existence. Appellant submits that this statute has no bearing on the present issues. Under the express limitation of the statute it is effective only with

* "Section 145. *Effect of power to revoke.* Where the grantor in a conveyance reserves to himself for his own benefit, an absolute power of revocation, he is to be still deemed the absolute owner of the estate conveyed, *so far as rights of creditors and purchasers are concerned.*" (Italics ours.)

respect to creditors of and purchasers from the transferor. As to creditors, the specialized statutory law which has been evolved for their protection is not to be construed as prescribing general principles applicable to cases where rights of creditors are not involved. As to purchasers from the transferor who reserves a power of revocation, assuming that such purchasers acquire good title in the absence of an express revocation, this is no more than logical since by the very act of transferring the property to such third parties the transferor exercises an implied and, indeed, a very practical revocation of his prior conveyance. For these reasons, it is submitted that the effect of the statute is not to change the well established law represented by *Van Cott* v. *Prentice, supra, Von Hesse* v. *MacKaye, supra,* and *Schreyer* v. *Schreyer, supra.*

Furthermore, there is grave doubt as to whether Section 145 applies to personal property at all. The cases which the Government heretofore has largely relied upon to support the proposition that it does relate to personalty (*Hutton* v. *Benkard,* 92 N. Y., 295; *Matter of Cooksey,* 182 N. Y., 92, 97; *Matter of Moehring,* 154 N. Y., 423, 427) arose under the New York Revised Statutes and prior to the adoption of the Consolidated Laws. Under the Revised Statutes, as stated in *Hutton* v. *Benkard, supra,* (p. 305):

> "It is provided that 'powers as they now exist by law are abolished, and from the time this chapter shall be in force the creation, construction and execution of powers shall be governed by the provisions of this article.' (3 R. S. [7th ed.] 2188, Sec. 73.) This language is very broad; broad enough to include all powers, both as to real and personal property."

Section 130 of the Real Property Law, however, now provides:

> "Sec. 130. *Effect of Article.* Powers, as they existed by law on the thirty-first day of December, eighteen hundred and twenty-nine, are abolished. Hereafter the creation, construction and execution of powers, *affecting*

real property, shall be subject to the provisions of this article; but this article does not extend to a simple power of attorney to convey real property in the name and for the benefit of the owner." (Italics ours.)

The article referred to is Article V, in which Section 145 is found.

We call attention particularly to the *new* words "affecting real property" contained in the current statute. This phrase, new in the Consolidated Laws, clearly appears to limit the general application of Article V of the Real Property Law to real property. If this is true, then Section 145 is irrelevant.

Since, in the instant case, legal title to the principal of the trust was at all times in the trustee and not in the donor and equitable title was in the beneficiary, the income taxed, in the words of District Judge Mack, "arose from property equitably owned for life by the beneficiary; this income came immediately into her possession through the hands of the trustee." (R., fol. 43) The case therefore does not present the situation of a present assignment of the right to receive future income where the title to the principal is at all times in the donor, such as *Bing* v. *Bowers,* 26 Fed. (2d) 1017 (C. C. A., 2d. Circ.) and *Mitchel* v. *Bowers,* 15 Fed. (2d) 287 (C. C. A., 2d Circ.). Rather it is a case where, by reason of the questioned statute, "A" has been taxed on income received by "B" which was derived from property the legal title to which was at all times while the income accrued in "C" and the equitable title in "B". "A" has been taxed on income which, in fact, he never received and which arose from property title to which was vested in another.

For the reasons above stated it is submitted that the reservation of the power of revocation does not create such a relationship between the donor and the principal of the trust as to permit this Court to consider that the income taxed arose from property owned by the donor. This case, therefore, does not present a situation involving principles analogous to those of constructive receipt.

Even if it be conceded that the existence of the power of revocation does enable the donor to exert a very real influence over the principal of the trust, it is believed that the existence of this power and its potentialities are immaterial. The taxing statute is concerned with income, not with principal. Regardless of the nature and extent of the powers of repossession and control which the settlor reserved over the principal of the trust, the income, once accrued, was completely and irrevocably the beneficiary's income, in which the settlor had no interest and over which he had no control. (N. Y. Surrogate's Court Act, Sec. 204.) This income was subject to the claims of the creditors of the beneficiary. (N. Y. Consol. Laws, Ch. 50, § 98.*) In this respect, therefore, revocable and irrevocable trusts are indistinguishable. The donor of a revocable trust has no greater interest in the distributable income of the corpus from the moment such income accrues than has the donor of an irrevocable trust.

There would seem to be little question that the income from an irrevocable trust cannot constitutionally be taxed to the donor, and the power of control which the donor of a revocable trust has over the principal is the only thing which the Government can possibly seize upon for justifying its action. Since the power of revocation with respect to the principal is immaterial, in view of the fact that the tax is a direct tax on income and is not affected by practical powers which may be exerted over the principal from which that income arose, appellant contends that the main ground on which the tax is sought to be justified completely fails. If it would be unconstitutional to tax the income of an irrevocable trust to the donor when he is not the recipient thereof, it is submitted that the present statute is unconstitutional.

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*The rule laid down by this statute has been extended by judicial construction to trusts of personalty as well as trusts of real estate. See *Brearley School* v. *Ward,* 201 N. Y. 358, 94 N. E. 1001; *Wetmore* v. *Wetmore,* 149 N. Y. 520, 44 N. E. 169; *Mills* v. *Husson,* 140 N. Y. 99, 35 N. E. 422.

This Court has already decided (*Irwin* v. *Gavit*, 268 U. S. 161) that the beneficiary of a trust is the owner of the income from the trust to such an extent that he may be subject to an income tax thereon. Appellant submits that, as a fundamental proposition, two people cannot each have such an interest in the same income that Congress, at its option, can levy an income tax against either on account of such income. If this be true, the established taxability of trust income to the recipient beneficiary precludes its taxability to the donor.

POINT II.

Congress cannot, by mere edict, declare that income actually received by the beneficiary shall be treated as the income of the creator of the trust.

As shown above, the beneficiary, Mrs. Corliss, was at all times, in every conceivable sense, the owner of and entitled to all the beneficial interest in and economic benefit of the income taxed. The right reserved by the donor was simply and solely the right to reacquire title to the principal of the trust fund, a right which was not exercised and which in the event of exercise would not have reached any income then accrued and held by the trustee. Therefore, the effect of the instant statute, baldly stated, is to declare that income of "A" shall be considered the income of "B". For the reasons above indicated, it is submitted that what counsel for the Government in the lower Courts called the *"nexus"* between "A" and "B" in the case of a revocable trust is immaterial because that *"nexus"* relates only to the principal and not to the income, with which alone the statute is concerned. Hence, the same principles are believed applicable which would apply if the donor and beneficiary had been total strangers or, in any event, if this had been an irrevocable trust instead of a revocable trust.

It is submitted that Congress has no power under these circumstances to declare that the income of Mrs. Corliss for purposes of income taxation shall be considered the income of Mr. Corliss. As the late Justice Moody said, in *Home Savings Bank* v. *City of Des Moines,* 205 U. S. 503, 511:

> "With respect to taxation, usually, if not necessarily, property and its owners are inseparable. Taxes are assessed against persons upon the property which they own, not upon property which others own."

The Sixteenth Amendment to the Constitution of the United States provides that Congress shall have power to lay and collect taxes on income from whatever sources derived, without apportionment among the several States, and without regard to any census or enumeration. This Court said in *Eisner* v. *Macomber,* 252 U. S. 189, at page 206:

> "As repeatedly held, this did not extend the taxing power to new subjects, but merely removed the necessity which otherwise might exist for an apportionment among the States of taxes laid on income."

And continuing, said:

> "In order, therefore, that the clauses cited from Article I of the Constitution may have proper force and effect, save only as modified by the Amendment, and that the latter also may have proper effect, it becomes essential to distinguish between what is and what is not 'income', as the term is there used; and to apply the distinction, as cases arise, according to truth and substance, without regard to form. *Congress cannot by any definition it may adopt conclude the matter, since it cannot by legislation alter the Constitution, from which alone it derives its power to legislate, and, within whose limitations alone that power can be lawfully exercised."* (Italics ours)

The Court, in the *Macomber* case, defined "income" in the following language:

> "*'Derived—from — capital'; — 'the gain—derived—from capital,' etc.* Here we have the essential matter;

not a gain *accruing to* capital, not a *growth* or *increment* of value *in* the investment; but a gain, a profit, something of exchangeable value *proceeding from* the property, *severed from* the capital however invested or employed, and *coming in*, being *'derived,'* that is, *received* or *drawn* by the recipient (the taxpayer) for his *separate* use, benefit and disposal;—*that* is income derived from property. Nothing else answers the description." (The italics are the Court's.)

In the *Macomber* case, the Supreme Court had before it the provision of the Revenue Act of 1916, which provided that there should be included in the term "dividends" any stock dividends, and expressly declaring that stock dividends should be considered income to the amount of their cash value. The Court held that Congress could not by any such definition declare to be income that which was in fact not income; that it could not by legislation alter the constitution "from which alone it derives its power to legislate." If Congress cannot declare to be income what is not in fact income, clearly it cannot declare to be the income of Mr. Corliss the income from securities, the legal title to which was not vested in him, and when in fact another person was entitled to and actually received such income. Such action on the part of Congress as to plaintiff is an act of confiscation in direct violation of the Fifth Amendment to the Constitution.

This Court, in the *Macomber* case, pointed out that Congress cannot disregard or ignore the substantial difference between the corporation and its stockholders and treat the corporate organization as unreal, or look upon the stockholders as partners when they are not partners. And yet, in the instant case, Congress has undertaken to ignore the very substantial difference between the income of Mr. Corliss and the income of Mrs. Corliss and has attempted to treat the receipt of income by Mrs. Corliss as not received by her but as in fact received by Mr. Corliss. If Congress cannot, in the exercise of its taxing powers, disregard the difference between the corporation and its stockholders, *a fortiori* it

cannot disregard the difference between Mr. Corliss' income and the income of Mrs. Corliss.

In the opinion of Solicitor Mapes (*supra*) where he had before him a trust indenture containing a power of revocation, and under which the settlor was the beneficiary of a part of the trust income, he said:

> "The trust being valid and passing a present right and title to the property, it cannot be held, under the facts presented, that the income arising therefrom belonged during his life to A, other than that amount which went to him as a beneficiary. Otherwise, the statute would impose an income tax upon income which was not received by the taxpayer. It would tax one person upon income 'received or drawn by the recipient'. (*Eisner* v. *Macomber*, 252 U. S. 189.) The income from this trust was not received or drawn by the creator of the trust, except such amounts as he received as a beneficiary. It was received by the beneficiaries, who were the only persons entitled to receive it while the trust remained in existence."

We find nothing in the recent decisions of this Court in *Taft* v. *Bowers*, 278 U. S. 470, and *United States* v. *Robbins*, 269 U. S. 315, inconsistent with this position.

In the *Taft* case this Court held that where property appreciated in value and then was given to another, Congress could follow such appreciation into the hands of the donee and tax him on the full amount thereof when the property was sold. In other words, this Court approved a statute which permitted the levying of a tax upon the party who received the income. The appreciation in the hands of the donor was not income within the meaning of the Sixteenth Amendment (*Eisner* v. *Macomber*, *supra*). "Income" was received only when the property was sold, and when the property was sold the party who received such income was the party taxed. This fact obviously was considered of great importance by the Court in view of its observation (p. 482):

> "In truth the stock represented only a single investment of capital—that made by the donor. And when

through sale or conversion the increase was separated therefrom, it became income from that investment *in the hands of the recipient* subject to taxation according to the very words of the Sixteenth Amendment. By requiring *the recipient of the entire increase* to pay a part into the public treasury, Congress deprived her of no right and subjected her to no hardship. She accepted the gift with knowledge of the statute and, as to the property received, voluntarily assumed the position of her donor. When she sold the stock *she actually got the original sum invested, plus the entire appreciation;* and out of the latter only was she called on to pay the tax demanded." (Italics ours.)

It is submitted that this is a totally different thing from permitting Congress to tax "A" upon the income of "B", which involves the constitutionality of taxing one who as a matter of fact did *not* receive the income taxed.

In the *Robbins* case the decision was that a husband could be taxed on the full amount of income received from property held jointly by husband and wife under the community property law of California. How clearly distinguishable that case is from the present proceeding is indicated by the analysis of the *Robbins* case as contained in a report of the Attorney General to the Secretary of the Treasury, dated June 24, 1925, quoted in the footnote below.*

It is interesting in this connection to note that Circuit Judge Anderson of the First Circuit in the case of *Hamilton*

*"In the *Robbins* case, consideration of the statutes and decisions in California, in an effort to analyze the substantial nature of the wife's interest in the community property, disclosed that during the existence of the community the husband had the right to complete dominion, possession, and control of the community property; that it was at all times liable for the husband's debts, both those created before his marriage and his separate debts after his marriage; *that he might expend the community property and community income as he pleased without accountability to the wife;* that the only restrictions (prior to 1917) on the husband's complete dominion were that he might not, without her consent, give away community property or dispose of household furniture or her wearing apparel; that the wife had no right to

v. *Commissioner*, 24 Fed. (2d) 668, in speaking of the *Robbins* case, says (p. 671):

> "* * * in which (case) the Supreme Court held that, under the community property law of California, *the wife had only an expectancy in the income* of the ganancial partnership * * *" (Italics ours).

On the basis of the authorities above discussed, it is respectfully submitted that the power of Congress to impose an income tax as granted in the Sixteenth Amendment is limited to the power to tax the recipient of the income, and that Congress cannot by mere edict declare that income of Mrs. Corliss shall be considered the income of Mr. Corliss for purposes of income taxation.

POINT III.

The Statute is so unreasonable and arbitrary as to be unconstitutional under the limitations of the Fifth Amendment.

This Court on a number of occasions has held that a federal taxing statute may be unconstitutional when it reaches a certain degree of unreasonableness and arbitrariness.

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have a share in the community estate expended for her benefit; that her right to maintenance and support was not based on the theory that one-half of the community estate belonged to her, but on a marital obligation of the husband arising out of the marriage relation; that the wife could not maintain any action during the existence of the community with respect to the community property; and was not a proper party to a suit involving the community property; that prior to 1923, on dissolution of the community, the wife had no right to make testamentary disposition of any part of the community estate; that if the husband died first the wife succeeded to half of what then remained of the community property after paying the husband's debts, including debts incurred by him before marriage as well as those in connection with his separate estate; that under an unbroken line

Nichols v. *Coolidge,* 274 U. S. 531;
Brushaber v. *Union Pacific Railroad Company,* 240 U. S. 71;
Blodgett v. *Holden,* 275 U. S. 142;
Barclay & Co. v. *Edwards,* 267 U. S. 442, 445;
Schwab v. *Doyle,* 258 U. S. 529;
Llewellyn v. *Frick,* 268 U. S. 238;
Untermyer v. *Anderson,* 276 U. S. 440.

Concededly, in the absence of the statute which is being attacked the income from the revocable trust would have been taxed to Mrs. Corliss. Congress considered it necessary to change this rule in order to prevent the evasion of surtaxes. (See Vol. I of House Reports, Sixty-Eighth Congress, First Session, dealing with H. R. 6715 [1924 Revenue Act] page 21; Vol. I of Senate Reports of same Congress and Session, page 25; Vol. IV of House Reports of same Congress and Session, pages 19-20.)

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of decisions in California the widow took as an heir and by succession; that the community estate was liable for the debts of the wife contracted prior to the marriage, the liability being based on the common law rule that on marriage the husband became liable for all the debts contracted by his wife *dum sola,* and in California the statute having exempted the husband's separate estate from debts of the wife contracted before marriage left only the community estate subject to them; that the community property was not subject to the separate debts of the wife contracted after marriage; and that in many other respects the wife in California had none of the rights in the community property ordinarily connected with ownership of property.

"It was shown that, whatever adjectives or descriptive terms may be used in an attempt to define the nature of the wife's interest, when it came to the ordinary rights of ownership they were completely wanting, and the alleged ownership of the wife in a share of the community estate in California was properly described as a 'barren ideality'.

"All these considerations were advanced in the Robbins case, and, while not dealt with at length in the opinion, no doubt form the basis for the conclusion reached." (Italics ours.)

Appellant denies that the motives actuating donors of revocable trusts in setting up such trusts are of any materiality in determining the constitutional questions involved. A taxpayer has the right to arrange his affairs and to carry on his business in such a way as to reduce his taxes to a minimum, thus legally avoiding taxes which otherwise might have been payable.

Bullen v. *Wisconsin*, 240 U. S. 625, 630;
U. S. v. *Isham*, 17 Wall. 496;
Fraser v. *Nauts*, 8 Fed. (2d) 106 (D. C., N. D. Ohio, W. D.);
Weeks v. *Sibley*, 269 Fed. 155 (D. C., N. D. Texas);
Walsh v. *Commissioner*, 18 B. T. A. 571.

But considering the bare actuality that the statute was passed because some taxpayers already had, and others might, resort to this means of cutting down surtaxes, it is submitted that the means adopted by Congress to prevent this result was arbitrary and unreasonable. Thousands of revocable trusts, in existence at the time the statute was passed, had been created before the enactment of the first income tax law in 1913, to meet a multitude of varying conditions. Still further thousands of such trusts must have been created after the inauguration of the surtax provisions of the income tax laws and before the enactment of the statutes involved here, for perfectly valid and bona fide purposes and without advertence to income tax considerations. It is by no means an unjustified assumption that even after the passage of § 219 of the 1924 Act many revocable trusts were created without any thought of the income tax. In spite of this situation, Congress concluded: "Since the device of the revocable trust may be used by some individuals for the purpose of evading surtaxes, despite the fact that there are an infinite variety of other circumstances which induce the creation of such trusts, we shall penalize all creators of revocable trusts and we shall conclusively 'presume' that all of such trusts were and would be created for the purpose of evading surtaxes."

Congress might have said that trust indentures containing the right of revocation shall be deemed to be presumptively fraudulent, or shall be deemed to be presumptively an attempt at evasion by the taxpayer, and thereby have shifted the burden of establishing good faith and freedom from evasion to the creator of the trust. But it did not. It treated all revocable trusts alike and took the position that regardless of how many revocable trusts, or how few, were created for the purpose of evading surtaxes, and regardless of whether or not there were any normal or surtaxes to be evaded, and regardless of whether or not any of such trusts were bona fide, it would assume that all donors of such trusts were and would be guilty of an attempt at evasion and it would not afford them an opportunity to prove that they were not.

With all due respect to the judgment of Congress in such matters, it is vigorously maintained that in this particular case its action is grossly arbitrary and unreasonable. Revocable trusts have not come into existence since the passage of the income tax laws. They have been recognized, valid instruments for many years and their very number is a graphic attestation to their utility under existing conditions. To be *suspicious* that all of them were and would be created for the purpose of evading surtaxes is unwarranted. To be *suspicious* that some of them have been used for the purpose is, we believe, justified. But *to assume conclusively* that all were and would be created with this purpose in view is so absurd as to render such words as "arbitrary", "unreasonable", and "capricious" wholly inadequate.

The case of *Schlesinger* v. *Wisconsin,* 270 U. S. 230, wherein this Court held that a state statute which conclusively "presumed" that all gifts made within six years prior to death were made in contemplation of death was unconstitutional, seems directly in point, and its pertinency is so obvious as to require no elaboration.

Perhaps it may be said in answer to this argument that the question of evading surtaxes is incidental and the vital factor is that since the donor could have acquired the income for himself, it is reasonable to tax him thereon. The ready

answer to such a contention is that whether or not the donor *could have done so,* the fact is, he did not, and to levy taxes on the basis of what people might have done is, to say the least, such an unsound theory of taxation that it should be promptly and firmly discouraged. The United States Board of Tax Appeals in *Appeal of Anna M. Harkness,* 1 B. T. A. 127, recognized this when it said (p. 130):

> "It seems to us to be fundamentally unsound to determine income tax liability by what might have taken place rather than by what actually occurred."

Surely counsel for the Government cannot maintain that, assuming the statute were not necessary to prevent avoidance of surtaxes, nevertheless, the tax would be reasonable because of what a taxpayer might have done but did not do.

POINT IV.

The taxation of the appellant upon the income of the trust beneficiary, cannot be justified as necessary to the enforcement of the admitted constitutional power to tax income.

If we correctly construe the opinions of the Courts below, their decisions rest upon the theory that the statutory provisions in question are necessary to prevent the evasion of surtaxes and may therefore be sustained under an implied power of Congress to do whatever is essential to make effective the authority contained in the Sixteenth Amendment to the Constitution.

Appellant vigorously denies that any such doctrine of "necessity" can render constitutional an otherwise unconstitutional statute. In *Schlesinger* v. *Wisconsin, supra,* this Court stated, relative to just such an argument of the purifying effect of necessity (p. 240):

> "The presumption and consequent taxation are defended upon the theory that, exercising judgment and

discretion, the legislature found them necessary in order to prevent evasion of inheritance taxes. That is to say, 'A' may be required to submit to an enactment forbidden by the Constitution if this seems necessary in order to enable the State readily to collect lawful charges against 'B'. Rights guaranteed by the federal Constitution are not to be so lightly treated; *they are superior to this supposed necessity.* The State is forbidden to deny due process of law or the equal protection of the laws for any purpose whatsoever." (Italics ours.)

In the more recent case of *Nichols* v. *Coolidge,* 274 U. S. 531 (at page 542) this Court has implied, wholly by way of dictum, that the taxation of gifts made in contemplation of death is dependent upon some such doctrine of ancillary power denied in *Schlesinger* v. *Wisconsin, supra,* but even in the *Nichols* case this Court was careful to note that "the right is limited by the necessity".

Admitting, therefore, but merely for the purposes of argument, that Congress does have the right to exert what would otherwise be unconstitutional powers in order to render effective the constitutional power to tax incomes, as limited by the language of this Court in *Nichols* v. *Coolidge, supra,* the exercise of such a power is unjustified in the situation presently involved.

Concededly, the trustee of the trust created by the appellant derived income within the meaning of the Sixteenth Amendment to the Constitution. It is equally clear that such income was received by Mrs. Corliss and can be taxed to her as such. (*Irwin* v. *Gavit,* 268 U. S. 161.) That case does not furnish the remotest authority, however, for the proposal to tax an individual upon income which he does not receive. On the contrary, *Irwin* v. *Gavit* clearly holds that income, as defined in the Sixteenth Amendment, can be taxed to the beneficiary of a trust who receives the same. Such income, being thus taxable, appellant submits that there is no "necessity" for Congress to invoke any ancillary constitutional power in this case.

None of the income of a revocable trust escaped tax prior to the enactment of the Revenue Act of 1924. There is no

occasion to speculate as to the power of Congress to tax one individual upon the income of another where the latter, by reason of other constitutional limitations, cannot be taxed upon the same. In the present case, the entire net income of the trust can clearly be taxed to the beneficiary, as it was taxed prior to the enactment of the 1924 Revenue Act. Congress is thus not put to the "necessity" of shifting the burden of the tax to some one who did not receive the income in order to collect a tax. "Necessity", as applied to the Sixteenth Amendment, cannot be construed other than as necessary in order to permit a tax to be collected upon "income from whatever source derived". As above indicated, no such necessity is involved in the instant case, and the mere preference of Congress, however laudable in purpose, to exact the highest rate of tax upon income, cannot justify the invocation of such ancillary constitutional power as Congress may have.

In this connection, the attention of the Court is again invited to its opinion in *Taft* v. *Bowers, supra.* There this Court said (pp. 482-483):

> "The provision of the statute under consideration seems entirely appropriate for enforcing a general scheme of lawful taxation. *To accept the view urged in behalf of petitioner undoubtedly would defeat, to some extent, the purpose of Congress to take part of all gain derived from capital investments. To prevent that result* and insure enforcement of its proper policy, *Congress had power* to require that for purposes of taxation the donee should accept the position of the donor in respect of the thing received. And in so doing, it acted neither unreasonably nor arbitrarily." (Italics ours.)

The clear inference from this language is that if the statute had not been necessary to enable Congress "to take part of all gain derived from capital investments", Congress would have acted "unreasonably" and "arbitrarily" in passing the statute. If this be true, thence since it is not necessary for Congress to tax the income of a revocable trust to the donor in order "to take part of all gain" derived from

the trust investments, inasmuch as the beneficiary would be taxable thereon under the decision of *Irwin* v. *Gavit, supra,* the present statute is unreasonable and arbitrary, and, therefore, unconstitutional.

It is submitted that Congress, by taxing to the donor income which, as a stark reality, he never received, and income which he had no right whatever to receive, has adopted a theory of taxation entirely inconsistent with the Sixteenth Amendment and in direct violation of the Fifth Amendment, and that the mere desire of Congress to concentrate incomes in such a manner as to yield a maximum *rate of tax* does not create a "necessity" justifying the disregard of accepted principles of constitutional and trust law

POINT V.

The statutory provisions in question are in any event unconstitutional as applied to the income of revocable trusts created prior to June 2, 1924, the effective date of the Revenue Act of 1924.

Even if this Court should consider that the statutory provisions under review are a valid exercise of an ancillary constitutional power, and are not arbitrary and unreasonable as applied to revocable trusts created since their enactment, we submit that they should be held unconstitutional as applied to trusts created prior to the enactment of the Revenue Act of 1924:

Nichols v. *Coolidge, supra;*
Blodgett v. *Holden, supra;*
Brewster v. *Gage,* 50 Sup. Ct. 115;
The Farmers' Loan and Trust Company v. *Bowers, supra;*
Brushaber v. *Union Pacific Railroad Company,* 240 U. S. 1, 20;
Barclay & Co. v. *Edwards,* 267 U. S. 442, 450.

Stated otherwise, what may be reasonable as applied to the income of trusts created after the effective date of the statute may be arbitrary and unreasonable as applied to the income of trusts created prior thereto, or, in any event, to such trust income as accrued prior to the effective date.

This Court obviously was influenced in its determination that the statute involved in the case of *Taft* v. *Bowers, supra*, was reasonable by the consideration that the donee "accepted the gift with knowledge of the statute and, as to the property received, voluntarily assumed the position of her donor" (see p. 482). In other words, the statute was considered reasonable because of its prospective operation and the fact that the act of giving was performed with a knowledge of the consequences. Such considerations are wholly inapplicable to the case of a revocable trust created prior to the enactment of Sections 219 (g) and (h) of the Revenue Act of 1924. In the instant case the donor did not make the gift "with knowledge of the statute" and therefore cannot be said to have acted with full knowledge of the consequences.

While the trust here involved was created in 1922, numerous trusts which will be affected by this Court's decision were created years prior to the inception of the present system of surtaxes, and have at no time since been modified or revoked. It is impossible to contend that such trusts were created for the purpose of evading surtaxes, and it is unreasonable, we submit, to penalize the donors of such trusts because of motives actuating others in the creation of revocable trusts.

For these reasons it is submitted that whether or not the application of the statutory provisions in question are arbitrary and capricious as applied to the income of revocable trust estates created subsequent to June 2, 1924, in any event such statutory provisions are arbitrary and capricious as applied to the income of estates created prior to that date and, as to such trusts, should not be sustained.

POINT VI.

The judgments of the District Court and of the Circuit Court of Appeals should be reversed, the motion to dismiss the complaint denied and judgment directed for the appellant as prayed for in the complaint.

Respectfully submitted,

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